

To be valid in Illinois a Certificate of Resale must contain the items of information listed in 86 Ill. Adm. Code 130.1405(b) (This is a GIL.)

November 8, 2000

Dear Xxxxx:

This letter is in response to your letter dated June 28, 2000 that we received on July 17, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be accessed at the Department's Website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

COMPANY is updating our tax files and creating training material for use in our customer service area. We would like to clearly define the conditions which qualify a sale as tax exempt in Illinois and what documentation is required to validate a sales tax exemption.

We are a manufacturer who sells primarily through distribution and are often faced with situations where customers do not feel a sale is taxable. For example, when material is shipped by us to a third party it is clearly for resale. Another example is when there is a tax exemption certificate in the chain of commerce. Our customer does not agree with our invoicing for sales tax. I need assistance to define your state's requirements to allow a sale to be tax exempt. I also need to know what specific forms or documents are required to support this exemption.

Please respond in writing to the following scenarios that have presented themselves to us in the past. In addition we request that you provide supporting documentation that we may use to clarify this position with our customers.

Your questions and our responses thereto are as follows:

1. Our customer possesses a tax exempt certificate from their home state, not Illinois. They have no physical address in Illinois. The order must be drop-shipped to a third party in Illinois. Can we accept the exemption from their home state? Our customer's position is the material is resold to a third party and no tax is due. If this is not acceptable, what documentation is needed to meet your tax exempt requirements.

You have described a drop-shipment situation in which a seller (A) makes a sale to an out-of-State company (B) and drop-ships the items to B's customer (C) located in Illinois. Company A (seller) has nexus with Illinois sufficient to require it to collect Use Tax on tangible personal property delivered to Illinois locations and it is registered with Illinois. Also, Company B (buyer) is not registered with Illinois.

As a seller required to collect the Illinois Tax, A must either charge tax or document an exemption when it makes a delivery in Illinois. In order to document the fact that the sale to B is a sale for resale, A must obtain a valid Illinois Certificate of Resale from its customer (B). The fact that B may be located in another state is immaterial and does not change the requirement for B to provide a valid Certificate of Resale to A. Because the sale involves a delivery to an Illinois location, the Certificate of Resale must be valid in Illinois and contain the items of information listed in 86 Ill. Adm. Code 130.1405(b), enclosed. If Company B does not provide acceptable Illinois documentation, seller A will be required to charge and collect tax from B on A's gross receipts from the transaction.

If B has no nexus whatever with Illinois, it is unlikely that it will be registered with Illinois. If that is the case, and if B has no contact with Illinois which would require it to be registered as an out-of-State Use Tax collector for Illinois, then it could obtain a resale number which would provide it the wherewithal to supply a required number to A in conjunction with a Certificate of Resale. We hope the following descriptions of out-of-State Use Tax collectors and persons who qualify for resale numbers will be useful.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts of sales and must collect the corresponding Use Tax incurred by purchasers.

So long as B does not accept purchase orders in Illinois, and so long as the items it sells are not located in Illinois at the time it sells them, it need not register as a retailer.

Out-of-State sellers who fall under the definition of a "retailer maintaining a place of business in this State" (see 86 Ill. Adm. Code Sec. 150.201(i), enclosed), must register to collect Illinois Use Tax from Illinois customers and remit that tax to the Department. See 86 Ill. Adm. Code Sec. 150.801(c), enclosed. The retailer must collect and remit Use Tax to the State on behalf of his Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The provisions of this regulation are subject to the recent U.S. Supreme Court ruling of *Quill v. North Dakota*, 112 S. Ct. 1902 (1992), in which the Supreme Court set forth guidelines for determining what nexus requirements must be met before a business is properly subject to a state's tax laws. *Quill* invoked a two-prong analysis consisting of 1) whether the Due Process Clause is satisfied, and 2) whether the Commerce Clause "substantial nexus" test is met before the state can impose tax collection responsibilities.

The due process test will be met if requiring the retailer to collect state sales tax is fundamentally fair to the retailer. If the retailer intentionally avails itself of the benefits of the taxing state's economic market, then due process is satisfied, Quill at 1910.

Notwithstanding the fact that due process has been met, a business must also have a physical presence in the taxing state in order for the "substantial nexus" test to be met under the Commerce Clause and before a state can impose tax collection responsibilities on an out-of-State retailer. A

physical presence does not mean simply an office or other physical building. Under Illinois tax law, it also includes the presence of any representative or other agent of the seller. The representative need not be a sales representative, and it is immaterial for tax purposes that the representative's presence is temporary.

If B has no contact with Illinois, it does not fall within the definition of a "retailer maintaining a place of business in this State", and it need not register as an out-of-State Use Tax collector.

Resale numbers are issued to persons who make no taxable sales in Illinois but who need the wherewithal to provide suppliers with Certificates of Resale when purchasing items which will be resold. So long as B does not act as an Illinois retailer and so long as it does not fall under the definition of a "retailer maintaining a place of business in this State", its sales to Illinois customers are not subject to Illinois Retailers' Occupation Tax liability and it cannot be required to act as a Use Tax collector. So long as this is true, it qualifies for a resale number which does not require the filing of tax returns with the Department. Information about acquiring a resale number can be obtained by calling the Department's Central Registration Unit at (217)-785-3707.

Please note that the fact that B may not be required to act as a Use Tax collector for Illinois does not relieve its Illinois purchaser of Use Tax liability. Therefore, if B does qualify for a resale number, its customer would have to pay its tax liability directly to the Illinois Department of Revenue.

Section 2c of the Retailers' Occupation Tax Act contains the following provision that would allow "other evidence" to be submitted by a purchaser to document the fact that its sale is for resale:

"Failure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence that all of the seller's sales are sales for resale or that a particular sale is a sale for resale." 35 ILCS 120/2c

Such evidence could consist of, for example, an invoice from B to its customer, showing that the item was actually resold, along with a statement from B explaining why it had not obtained a resale number and certifying that the purchase was a purchase for resale in Illinois. While "other evidence" is acceptable under the law, we prefer that B obtain a resale number and provide that number on a Certificate of Resale. There is a strong possibility that an Illinois tax auditor will scrutinize "other evidence" more closely than a Certificate of Resale.

2. Our customer possesses a tax exempt certificate from their home state, not Illinois. They have no physical address in Illinois. The order must be drop-shipped to a Federal Government Job, Municipal Project, State Project or County Project in Illinois. Our customer presents us with a tax exemption certificate issued for this job. Under what condition is this certificate acceptable? If this is not acceptable, what documentation is needed to meet your tax exempt requirements.

Based upon the limited information provided in this question, we cannot give a definite answer. For instance, the nature of the exemption claimed by your customer is of central importance. However, we will provide the following general information for your consideration. Under Illinois law the Department issues tax exemption identification numbers to governmental bodies that they can present to vendors to document that a transaction is exempt from sales tax. See 86 Ill. Adm. Code 130.2007 and 130.2080, enclosed. This would be the documentation that you should obtain if the

sale to your customer constitutes a sale to a governmental body. If this is not the case and your customer is reselling the item, see the answer to Question 1. However, if your customer is a contractor working on a job site, your sale to him will generally be taxable. Contractors incur Use Tax on the tangible personal property permanently installed into real estate. See, Section 130.1940 and 130.2075. There are limited exceptions to this rule if the contractor is permanently installing tangible personal property into real estate owned by an exempt entity.

3. We have a customer who is normally taxable. Most orders are shipped to their inventory and they pay tax on these shipments. On some orders this customer presents us with an Illinois tax exempt certificate for a specific project. The material is not shipping direct to the job because our customer must fabricate or process this material in some manner before shipping to the job. They claim that they should not pay tax because the job is tax exempt and they cannot collect the tax. What are your requirements to allow a tax exemption in this scenario?

Based upon the limited information presented, we can only provide the following general information. If the customer is purchasing the material for resale, they should provide a certificate of resale as described in our response to Question #1. If the customer is purchasing the material for its own use, as in the case of a construction contractor, then it is taxable even if the customer cannot collect tax from its customer.

4. Our customer possesses a tax exempt certificate from their home state, not Illinois. They have no physical address in Illinois. The order must be drop-shipped to a third party in Illinois. May we accept a valid Illinois tax exemption certificate from the third party whom we shipped to in lieu of a certificate from our billing customer? Also, what if this third party came to our warehouse in Illinois and picked up the material? Is this transaction tax exempt?

See our response to Question #1. Please be advised that your delivery of goods in Illinois makes the transaction subject to Retailers' Occupation and Use Tax unless your customer can document an exemption.

5. Is material shipped to a qualified 'In Process Manufacturer' in Illinois for ultimate delivery to a location outside Illinois? Our customer has no physical address in Illinois. Can we accept the third party exemption of the 'In Process Manufacturer?'

We do not know what you mean by an 'In Process Manufacturer.' Again, the amount of information provided is limited. As noted in our responses above, your customer, not your customer's customer, must generally give a resale or exemption certificate if delivery is made in Illinois.

6. Is a shipment to a qualified freight forwarder in Illinois for ultimate delivery outside Illinois, exempt from sales tax? What documentation is required to validate this exemption?

Retailers' Occupation Tax and the complementary Use Tax do not apply where the seller ships goods by carrier (where the purchaser is not also the carrier) or by mail, according to the terms of the

agreement with the purchaser, and the seller delivers the goods from a point within Illinois to a point outside Illinois and the goods are not to be returned to Illinois. Please refer to 86 Ill. Adm. Code 130.605. Illinois cannot tax transactions where the sales agreement requires the seller to ship the goods directly to a point outside the United States because a provision in the United States Constitution reserves to Congress the right to regulate foreign commerce. Thus, if a purchase is made in Illinois and delivered by the seller to a foreign destination, it is exempt from Illinois tax.

An exemption on the basis of foreign commerce is also available where an Illinois seller makes delivery in Illinois to a freight forwarder who handles the arrangements for the property to be delivered outside the United States, not to be returned to the United States. In order to document the exemption, the seller should obtain a statement from the purchaser that the property would be used exclusively outside the United States and a shipping document showing delivery of physical possession of the property to a freight forwarder in Illinois. Please note the purchaser would incur Illinois tax if he received or picked up the goods prior to delivery to a freight forwarder.

7. Our out of state customers wants to pick up material at our warehouse in Illinois and deliver material to a location out of state to their warehouse or their customer. Under what condition is this transaction exempt?

Accepting delivery of goods in Illinois generally makes the transaction subject to Retailers' Occupation and Use Tax unless the purchaser can document an exemption. One possible exemption is to give the certification described at 86 Ill. Adm. Code 130.1405(b)(5)(C).

8. Can we accept an Illinois tax exemption certificate from a parent company and extend the exemption to subsidiaries of this parent company? Under what conditions can this be done?

Assuming the subsidiaries are separately registered for Illinois tax purposes, you would have to obtain exemption documentation from the subsidiary, not the parent.

9. Can we accept a valid tax exemption certificate issued after an order has been shipped? Example; We shipped material in January but the Illinois exemption was not issued until February. Is the February exemption valid for the January sale?

Although exemption documentation is supposed to be obtained at the time of sale, if a purchaser provides exemption documentation a month after a sale, the exemption document can generally relate back to the time of sale. If a resale certificate is used to document the resale exemption per the provisions of Section 130.1405, the registration or resale number must be valid on the date the exemption was claimed. If tax was already collected and remitted the seller can refund the tax to the purchaser and apply for a credit pursuant to the provisions of 86 Ill. Adm. Code 130.1501, enclosed.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Karl W. Betz
Associate Counsel

KWB:msk
Enc.